MPC meet | More on caution, less on activism

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In line with our expectations, today's monetary policy decision was primarily influenced by the uncertainty created by the emergence of the COVID-19 variant omicron and lingering imbalances in the economic recovery.

While all the six members of the MPC unanimously voted to keep the policy rate unchanged, five members voted to continue with the accommodative stance to support growth revival on a durable basis.

In his statement, the RBI governor has explained the rationale behind today's policy in terms of lagging private investment, uncertainty created by omicron and weak private consumption that is still below its pre-pandemic levels. While the economic recovery that was interrupted by the second wave of COVID-19 is regaining traction, it is not yet strong enough to be self-sustaining and durable, asserted the RBI governor.

Amid the omicron scare, even the Bank for International Settlements (BIS) — the central bank to the world's central banks — has cautioned that policymakers and financial markets cannot lower their guard on COVID-19 and will have to calibrate their policies carefully.

According to the BIS, omicron could exacerbate supply-chain bottlenecks in the short run and adversely impact economic activity, particularly in the first quarter of 2022.

Combining both the positive and negative influences on growth and assuming no resurgence in COVID-19 infections in India, the MPC has retained projection for India's real GDP growth at 9.5 percent in 2021-22 (FY22) consisting of 6.6 percent in Q3, FY22 (earlier projection – 6.8 percent) and 6.0 percent in Q4, FY22 (earlier 6.1 percent).

Incidentally, Fitch Ratings has slashed India's growth forecast today (Dec 8th) for FY22 from 8.7 percent earlier to 8.4 percent given that less than one-third of the population is fully vaccinated and the new omicron variant poses a new risk to the recovery.

The MPC has retained its headline CPI inflation projection for FY22 at 5.3 percent with 5.1 percent in Q3, FY22 (earlier 4.5 percent) and 5.7 percent in Q4, FY22 (earlier 5.8 percent).

Interestingly, Fitch Ratings expects India's headline inflation to average 4.9 percent in 2022 from 5.0 percent in 2021, amid moderate food inflation. The MPC also expects food inflation to moderate in the coming months with the winter arrivals for vegetables & fruits.

In its today's press note even Fitch Ratings has said that "a large negative output gap and inflation close to the midpoint target should allow the RBI to lag many other emerging markets peers in the interest-rate-normalisation process. However, the RBI will continue to roll out liquidity withdrawal auctions to reduce excess liquidity in the banking system".

The RBI has precisely done this in today's policy by making appropriate use of the available policy space. While staying pat on the rates and stance, it has increased quantum of VRRR (variable rate reverse repo) of 14-day tenor to Rs 6.5 lakh crore by December 17 from the current Rs 6 lakh crore and to Rs 7.5 lakh crore by December 31st. It has also announced that from January 2022 onwards, liquidity absorption will be undertaken mainly through the auction route.

The RBI's well calibrated approach to liquidity normalisation has already helped short-term (money market) rates move higher by 15-20 bps since the last monetary policy review in October. Now the proposed liquidity management through the auction route from January, 2022 onwards may push these rates even further – closer to the repo rate, if the RBI opts for shorter tenor auctions.

A few important regulatory and developmental measures are also announced in today's policy. First, to provide higher operational flexibility, banks are given permission to infuse capital in their overseas branches & subsidiaries if they are meeting the regulatory capital requirements.

Second, for external commercial borrowings and trade credits (currently benchmarked to LIBOR), new guidelines are being issued to facilitate their transition away from the LIBOR to Alternative Reference Rates (ARRs).

Third, discussion papers are getting prepared on the review of prudential norms for banks' investment portfolios and on charges in payment systems.

Fourth, in order to further deepen digital payments and make them more inclusive a number of steps are being taken such as launching of UPI-based payment products for feature phone users, simplifying the process flow for small value transactions and raising the transaction limit for payments through UPI, etc.

In his concluding remarks, the RBI governor has warned that despite the ongoing economic recovery, Indian economy cannot remain immune to global spillovers or to possible surges of infections from new COVID-19 mutations. A cautious approach to monetary policy may be prudent during times of uncertainty like today.

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